

Notice 2002-50; 2002-28 IRB 1 (25 Jun 2002)
Partnership Straddle Tax Shelters
Part III -- Administrative, Procedural, and Miscellaneous

[1] The Internal Revenue Service and the Treasury Department have become aware of a type of transaction, described below, that is being used by taxpayers for the purpose of generating deductions. This notice alerts taxpayers and their representatives that the tax benefits purportedly generated by these transactions are not allowable for federal income tax purposes. This notice also alerts taxpayers, their representatives, and promoters of these transactions of certain responsibilities that may arise from participating in these transactions.

FACTS

[2] This transaction involves partnerships manipulated through a series of steps carried out in the following order. No § 754 election is in effect at any relevant time. Step 1: Corporation acquires a majority interest in an upper tier partnership (UTP) at fair market value. Step 2: UTP acquires a majority interest in a lower tier partnership (LTP) at fair market value. Step 3: LTP enters into straddles on foreign currencies and may acquire other assets. Step 4: LTP terminates the gain leg of a foreign currency straddle. LTP allocates a pro rata share of the gain to UTP, which in turn allocates a pro rata share of the gain to Corporation. This gain increases the basis of each partnership interest. Step 5: Corporation sells its interest in UTP to Taxpayer at fair market value. This results in a loss to Corporation sufficient to offset the gain that was allocated to Corporation. Step 6: Taxpayer purchases UTP's interest in LTP at fair market value. UTP realizes a loss on this sale, but the loss is disallowed under § 707(b)(1)(A) because Taxpayer owns more than 50% of UTP. Step 7: LTP engages in a transaction that is intended to increase Taxpayer's basis in the LTP interest. For example, LTP may incur a liability that Taxpayer guarantees. LTP then terminates the loss leg of the foreign currency straddle and allocates a pro rata share of the loss to Taxpayer. Step 8: Taxpayer sells the interest in LTP at its fair market value and realizes gain (for example, from the relief of liability). Taxpayer then claims that this gain is offset under § 267(d) by the amount of the loss that was disallowed to UTP under § 707(b)(1)(A).

ANALYSIS

[3] The transaction described in this notice has been designed to use a straddle, a tiered partnership structure, a transitory partner, and the absence of a § 754 election to allow Taxpayer to claim a permanent non-economic loss. The Service intends to challenge the purported tax benefits from this transaction on a number of grounds. First, the Service expects that the partnership anti-abuse rule contained in § 1.701-2(b) of the Income Tax Regulations will generally disallow the deduction claimed by the Taxpayer upon the termination of the loss leg of the straddle. See § 1.701-2(d) (Ex. 8) (disallowing duplication of a built-in loss deduction attributable to the absence of a § 754 election). Second, the Service may challenge the allowance of the loss deduction based on other statutory provisions, including § 988, and judicial doctrines, including the step transaction doctrine and the doctrines of economic substance, business purpose, and substance over form. Third, the Service may assert that, where a loss is disallowed on the sale of a partnership interest under § 267(a)(1) or § 707(b)(1), § 267(d) must be applied

under an aggregate approach rather than an entity approach. See § 1.701-2(e) (requiring aggregate treatment of partnerships for certain purposes). Because the gain realized by Taxpayer on the sale of its interest in LTP does not correspond to any increase in the value of the assets within LTP, the disallowed loss realized on the sale of LTP by UTP cannot be used to offset the gain under an aggregate approach.

[4] Transactions that are the same as, or substantially similar to, the transaction described in this notice are identified as "listed transactions" for purposes of § 1.6011-4T(b)(2) of the temporary Income Tax Regulations and § 301.6111-2T(b)(2) of the temporary Procedure and Administration Regulations. *See also* § 301.6112-1T, A-4. For purposes of § 1.6011-4T(b)(2) and § 301.6111-2T(b)(2), a transaction will be considered the same as, or substantially similar to, the transaction described in this notice even if, at the time relevant for making such determination, the taxpayer in such transaction has not engaged in a step having the effect of Step 8.

[5] Persons who are required to satisfy the registration requirement of § 6111 with respect to the transaction described in this notice and who fail to do so may be subject to the penalty under § 6707(a). Persons who are required to satisfy the list-keeping requirement of § 6112 with respect to the transaction and who fail to do so may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on participants in this transaction or substantially similar transactions or, as applicable, on persons who participate in the promotion or reporting of this transaction or substantially similar transactions, including the accuracy-related penalty under § 6662, the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701.

[6] The principal author of this notice is Heather Faught of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Faught at (202) 622-3060 (not a toll-free call).
